

Essential Utilities, Inc.

WTRG: Analyst Day Wrap Up -- Adjusting EPS Outlook

Equal Weight/\$45

Water Utilities

Price Target Change

• **Key Points.** WTRG's 2/27 analyst day provided clarity around the company's EPS power for the next few years. After reporting adjusted '19 EPS of \$1.47 (reflects the base water business without the impacts from external financings completed in 2019 for the Peoples acquisition), '20 EPS are expected to be \$1.53-1.58 (pro forma for a 1/1 Peoples close vs. the anticipated 3/16). In addition, management forecasts a 5-7% EPS CAGR through '22 off the \$1.47 base. This trails expected consolidated rate base growth of roughly 8% due to earned ROEs at recent/pending muni deals not yet earning the full keep plus some dilution. However, once another PA water rate case goes into effect (we assume a '21 filing; rates effective '22), then it sounds like EPS growth should track more closely to rate base growth. After flowing '19 actuals and analyst day disclosures through our model, we lower our 20-22E EPS to/from \$1.56/\$1.57, \$1.65/\$1.70 & \$1.77/\$1.80. We project a 6.5% EPS CAGR through '24. No change to our overall thesis or Equal Weight rating despite recent underperformance (down 10% since 2/18 relative to the S&P Utilities) as shares trade in-line with a 70% water/30% gas LDC blended multiple. We lower our 12-18 month price target to \$45/share from \$48 (26X our 22E) due primarily to lower peer group multiples since our last update.

• **EPS Outlook.** Our 2020-24E EPS are \$1.56, \$1.65, \$1.77, \$1.90 & \$2.02. The addition of Peoples (3/16 close expected), including the \$0.08-0.12 of EPS benefits anticipated by electing and flowing through the current portion of RTD at Peoples Gas, is what allows WTRG to guide to 2020 pro forma EPS of \$1.53-1.58 (as if the deal closed 1/1). Our prior outlook did not include the RTD benefits – which we thought offered \$0.10-0.15 upside – however we, as well as most investors that we have talked to, did not appreciate the headwinds facing the base water business in '20. This led to the guidance being viewed as somewhat disappointing and shares underperforming. After reporting adjusted '19 EPS of \$1.47, management indicated 2020 base water EPS would have been relatively flat, all else equal. This is because (1) '19 benefited from the PA water repair tax deduction flowing to shareholders until new PA rates were effective mid-May, (2) there is roughly \$200M of recent municipal system acquisition rate base additions that are not yet earning the allowed ROE in '20 (may actually be closer to break-even) and (3) the absence of any PA DSIC revenues until '21.

• **WTRG's Strategy.** The core growth drivers remain twofold. (1) Reinvest aggressively in existing systems and seek timely regulatory recovery. 2020 capex is \$550M for water and \$400M for gas with a total of \$2.8B budgeted over the 2020-22 period. And we do not expect any falloff in those levels for the foreseeable future. (2) Actively pursue municipal M&A. **Comment continues on p. 2**

	2019A	2020E	2021E
\$ EPS		Curr. Prior	Curr. Prior
Q1 (Mar.)	0.28	0.62	NE
Q2 (June)	0.37	0.23	NE
Q3 (Sep.)	0.48	0.24	NE
Q4 (Dec.)	0.34	0.47	NE
FY	1.47	1.56	1.57 1.65 1.70
CY	1.47	1.56	1.65
FY P/EPS	29.3x	27.6x	26.1x
Rev.(MM)	890	1,927	2,058

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters
 NA = Not Available, NC = No Change, NE = No Estimate, NM = Not Meaningful
 V = Volatile
 Adjusted EPS excludes items considered non-recurring.
 WTR expects 2020 adjusted EPS of \$1.53-1.58 and targets a 5-7% EPS CAGR through 2022 off the 2019 adjusted base of \$1.47

Ticker	WTRG
Price Target/Prior:	\$45/\$48
Price (02/28/2020)	\$43.01
52-Week Range:	\$34-55
Shares Outstanding: (MM)	220.8
Market Cap.: (MM)	\$9,496.6
S&P 500:	2,954.22
Avg. Daily Vol.:	1,204,010
Dividend/Yield:	\$0.94/2.2%
LT Debt: (MM)	\$3,077.0
LT Debt/Total Cap.:	44.1%
ROE:	9.0%
3-5 Yr. Est. Growth Rate:	6.0%
CY 2020 Est. P/EPS-to-Growth:	4.6x
Last Reporting Date:	02/26/2020
	After Close

NC = No Change

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters

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Please see page 3 for rating definitions, important disclosures and required analyst certifications. All estimates/forecasts are as of 03/02/20 unless otherwise stated. 03/02/20 06:51:16 ET

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- **WTRG's Strategy (continued...).** Deal activity in the industry remains elevated, in large part due to states adopting FMV legislation, and WTRG is in various levels of discussions with systems representing a total of 320,000 customers. Besides PA and IL, WTRG seems to believe OH, TX and KY hold the most promise. Management's compensation is tied to a \$60M/yr deal value target and the goal is to achieve 2-3% customer growth through organic and M&A. Management believes the capex budget can be financed without new equity whereas deal flow would require roughly 50% new equity, perhaps through the establishment of an ATM program in front of the DELCORA deal close (expected late '20). Speaking of DELCORA, enthusiasm remains high for the deal from the immediate rate base addition, meaningful future capex needs (\$700M by 2028) as well as potential bolt-on wastewater deals perspectives. Other management priorities outlined at the analyst day include completing/integrating the Peoples and DECLORA transactions as well as maintaining ESG appeal (highlighted recent diversity and governance enhancements).

Acronyms:

ATM – At-the-market
 DSIC – Distribution System Improvement Charge
 ESG – Environmental, Social, and Governance
 FMV – Fair Market Value
 RTD – Repairs Tax Deduction

Price Target

Price Target: \$45 from \$48

Our \$45/share price target reflects both a P/E multiple and DDM analysis. In terms of P/E, we apply a 2.5% discount to our 70% water/30% gas utility hybrid multiple to our 2022E of \$1.77. The 2.5% discount reflects merger execution/integration risk. For WTRG's water utility multiple, we start with AWK's 2021 P/E multiple of 29.4X (AWK represents the closest publicly traded peer) and apply a 5% discount (given AWK's higher growth rate and best-in-class management team). For WTRG's gas utility multiple, we utilize the 2021 pure play gas LDC median of 21.2X. Key risks include regulatory and M&A strategy execution related.

Investment Thesis

We are attracted to WTRG's strong fundamentals - a proven EPS growth strategy, a growing rate base, constructive regulation, efficient operations and a strong balance financial profile. Our Equal Weight rating reflects valuation considerations in light of WTRG's pending agreement to acquire Peoples (a gas utility) and the associated P/E multiple, regulatory and deal execution/integration related risks.

Company Description

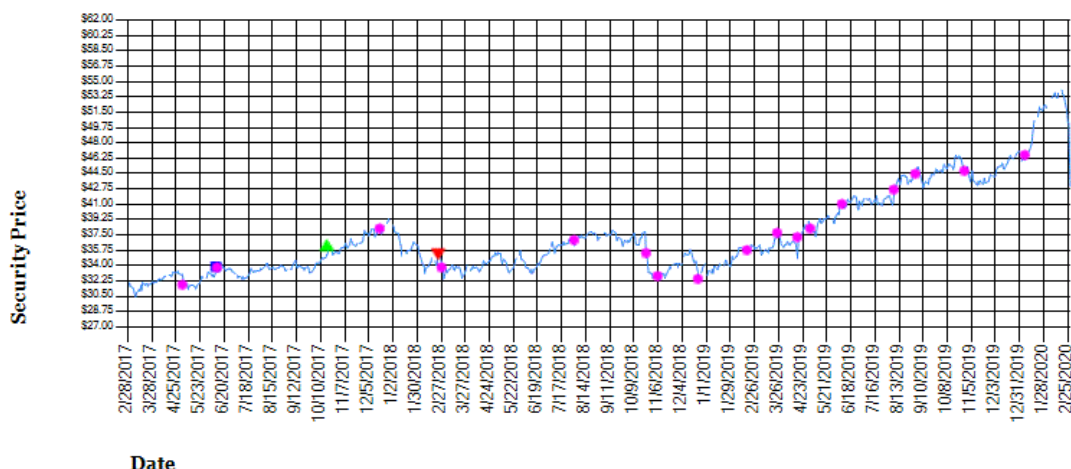
Headquartered in Bryn Mawr, PA, Essential Utilities (WTRG) - formerly Aqua America - is one of the largest U.S.-based investor-owned regulated water and wastewater utilities. The company serves approximately 3 million residents (1 million customer connections) in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, Indiana and Virginia. WTRG's largest subsidiary, Aqua Pennsylvania, accounts for approximately half of the company's total water customer base and nearly 70% of consolidated water rate base. Going forward, the company has expressed a desire to accelerate customer growth through a more active and focused acquisition strategy across its entire portfolio. Regulated operations account for more than 99% of consolidated revenues.

On 10/23/18, WTRG announced a deal to acquire Peoples - a predominately Pennsylvania-based gas utility serving 740k customers - from SteelRiver Infrastructure Partners for an enterprise value of \$4.275B (includes \$1.3B of assumed debt). From a price perspective, the deal appears to be 1.9-2.0X rate base, 14.8X EV/EBITDA and nearly 25X P/E - lofty multiples but not that dissimilar to what we have seen in recent gas utility transactions. WTRG received PA regulatory approval on 1/16 and the deal is expected to close imminently. Management expects the deal to be EPS accretive in the first full year after close (2020) but stressed this is a strategic-driven, not synergy-driven, transaction.

On 2/3, the new name Essential Utilities, Inc. and new ticker WTRG became effective. Prior, the company was known as Aqua America Inc. and traded under the ticker WTR.

Required Disclosures

Essential Utilities, Inc. (WTRG) 3-yr. Price Performance



Date	Published Price (\$)	Rating Code*	Price Target	Val. Rng. Low	Val. Rng. High	Close Price (\$)
2/28/2017		Kalton				
2/28/2017	NA	2	NE	31.00	33.00	31.74
5/4/2017	31.70	2	NE	32.00	34.00	31.73
6/13/2017		Reeder				
6/13/2017	33.62	2	35	NE	NE	33.62
10/19/2017	35.30	1	40	NE	NE	36.03
12/18/2017	38.14	1	43	NE	NE	38.03
2/25/2018	35.00	2	37	NE	NE	35.00
3/1/2018	34.19	2	36	NE	NE	33.66
8/2/2018	36.70	2	38	NE	NE	36.70
10/24/2018	35.01	2	37	NE	NE	35.29
11/6/2018	32.70	2	35	NE	NE	32.59
12/24/2018	33.87	2	34	NE	NE	32.38
2/19/2019	35.54	2	36	NE	NE	35.52
3/26/2019	37.52	2	39	NE	NE	37.52
4/18/2019	36.52	2	38	NE	NE	37.15
5/3/2019	37.85	2	39	NE	NE	38.09
6/9/2019	40.84	2	42	NE	NE	40.84
8/8/2019	42.06	2	44	NE	NE	42.47
9/2/2019	44.29	2	47	NE	NE	44.29
10/29/2019	44.90	2	46	NE	NE	44.68
1/8/2020	46.51	2	48	NE	NE	46.51

*Effective December 7, 2019, Wells Fargo Securities' Equity Research modified its ratings definitions. Complete definitions of current ratings can be found below. For information related to prior ratings definitions, please contact equityresearch1@wellsfargo.com.

Source: Wells Fargo Securities, LLC estimates and Reuters data

Symbol Key

- ▼ Rating Downgrade
- ▲ Rating Upgrade
- Price Target/Val Range Change
- ◆ Initiation, Resumption, Drop or Suspend
- Analyst Change
- ◻ Split Adjustment

Rating Code Key

- 1 Overweight/Buy
- 2 Equal Weight/Hold
- 3 Underweight/Sell
- SR Suspended
- NR Not Rated
- NE No Estimate

Additional Information Available Upon Request

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WTRG: Key risks include regulatory and M&A strategy execution related.

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2=Equal Weight: Total return on stock expected to be 0-10% over the next 12 months. HOLD

3=Underweight: Total return on stock expected to lag the Overweight- and Equal Weight-rated stocks within the analyst's coverage universe over the next 12 months. SELL

VOLATILITY RATING

V = A stock is defined as volatile if the stock price has fluctuated by +/-20% or greater in at least 8 of the past 24 months or if the analyst expects significant volatility. All IPO stocks are automatically rated volatile within the first 24 months of trading.

As of: March 2, 2020

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